SMALL BUSINESS, COMMON SENSE STANDARDS & FORCED ARBITRATION

A REPORT FROM MAIN STREET
INTRODUCTION

The COVID-19 pandemic has highlighted how important small businesses are to our communities, our local economies, and the wellbeing of the country as a whole. However, with large corporations profiting from the pandemic while small businesses fight for survival, the playing field has become even more tilted in favor of big business. This is perhaps most evident in the growing market dominance of large retailers that have used their online advantage to crowd out smaller competitors. Yet there is another way large corporations and other unscrupulous actors have flexed their muscle to the disadvantage of responsible businesses — by flouting worker health, safety, and wage protections.

Now more than ever, small businesses need a foundation of public policy that recognizes the value of Main Street businesses to workers, families, and communities. This policy foundation includes consistent, common-sense workplace standards — including health and safety rules, wage floors, and anti-discrimination protections — that level the playing field for responsible business owners, help small businesses attract and retain talented employees, and sustain a thriving economy.

Even before the pandemic, large corporations and unscrupulous employers began taking steps to dismantle this foundation through legal maneuvering. These corporations started to require workers and customers to sign forced arbitration clauses that strip employees and customers (including small businesses) of the ability to enforce protections before a judge and jury. Under these clauses, individuals hurt by harmful corporate practices are left with a private arbitration system — where large corporations write the rules. This strategy gives these corporations an end-run around common-sense workplace standards. In the midst of the pandemic, big businesses even sought to go further, asking Congress to legally immunize them for exposing employees to COVID-19. While Congress has not passed such legislation, it gained traction in many states.

This makes the work of public agencies — looking out for the interests of workers and responsible small businesses — especially important when it comes to both setting and enforcing common-sense health, safety, and other workplace standards. In recent years, however, these agencies have been severely under-resourced and underfunded. This is another win for large corporations over small businesses that diligently assume the cost of compliance.

Policymakers have options at their disposal to ensure consistent application of workplace standards and protect small businesses and workers alike. At the state level, policymakers can adopt models, such as whistleblower enforcement in conjunction with state agencies, that prevent unscrupulous competitors from profiting from workplace violations. At the federal level, policymakers can ban forced arbitration and collective-action waivers to help level the playing field for responsible businesses.

Role of the Small Business Sector in the Economy

According to the Small Business Administration (SBA), heading into the pandemic there were more than 30 million small businesses in the U.S, accounting for more than 99 percent of all businesses in the country and employing nearly half of the country’s private sector workforce (almost 60 million people). Small businesses, not large companies, led the way out of the Great Recession, generating most of the country’s net new jobs (2 out of 3 private sector jobs). With proper support, small businesses can play a similar role in rebuilding from COVID-19.

Small, independent businesses also spur investment in local communities. Compared to large businesses, they are more likely to purchase from local sources, hire locally, and pay local taxes — contributing to a “virtuous cycle of local spending” that adds revenue for important services, generates jobs for residents, and contributes to investments in infrastructure and education. By reinvesting their profits locally in this
way, small firms help build community resilience during economic downturns.\textsuperscript{9,10}

However, in order to grow and contribute to prosperous local economies, small businesses need support, too. That support includes public policy that helps level the playing field for small business owners, their employees, and the communities they serve.

Small Business Need Consistent, Common-Sense Workplace Protections

Main Street small businesses count on consistently-applied, common-sense job quality standards to sustain a strong workforce and support a thriving economy. Wage floors, protections against sexual harassment, and health and safety rules and other protections promote stability and longevity for small firms and create a foundation of prosperity for the small business sector as a whole. These standards also set the terms of competition for firms in a given sector and contribute to a more level playing field across businesses.

Regulation of business receives widespread support from business owners themselves. According to a survey conducted for Small Business Majority in 2018, 80 percent of small business owners surveyed believe that “some regulation of business is necessary for a modern economy.” Additionally, 78 percent strongly or somewhat agree that “some regulations are important to protect small businesses from unfair competition and to level the playing field with big business.”\textsuperscript{11}

As these figures indicate, many Main Street small business owners understand that the absence of job quality standards allows large corporations to use their size and power to cut costs (including labor costs) and squeeze smaller competitors.

This is why comprehensive workplace protections are so important. When consistently applied, high-road standards create long-term benefits for Main Street businesses, reducing employee turnover, increasing worker productivity, and helping small businesses succeed in the market. Minimum wage increases, for example, have a positive effect on absenteeism\textsuperscript{12} and turnover.\textsuperscript{13} Paid sick days yield similar benefits when it comes to turnover and productivity. For instance, in Austin, Texas, a cost-benefit analysis of the city’s new paid sick days policy projected net savings of $4.5 million each year for area businesses, resulting primarily from reduced turnover.\textsuperscript{14}

These benefits are especially important to small businesses, which work hard to recruit and retain talented staff. Turnover costs typically equal approximately 20 percent of an employee’s annual salary.\textsuperscript{15} Weathering such costs often requires margins and economies of scale that small businesses lack compared to large businesses, which have human resources departments to recruit, hire, and train employees.\textsuperscript{16}

“Safety is important in a woodworking shop, but maintaining high safety standards can be costly. If large competitors can use forced arbitration to shield themselves from the consequences of exposing their workers to harm, that hurts those of us who play by the rules and care for our employees. It’s hard enough running a profitable business. We shouldn’t be forced to compete with people that are putting their employees at risk because they’re ignoring safety standards.”

Tony Sandkamp, Sandkamp Woodworks, NJ
Beyond these benefits, small businesses rely on the broader economic activity that workplace standards support. Workers are also clients and customers at the businesses in their communities; research shows that, when wages are increased, low-wage workers spend that additional income locally, stimulating the local economy. In economic downturns, small firms are less likely than large firms to obtain capital for adjusting to lower consumer demand, as financial institutions are much more likely to deny them credit or other financing. Accordingly, consistent workplace standards, running across businesses and sectors, are of particular importance to Main Street businesses.

Moreover, when applied evenly, these standards set positive terms of competition for firms, helping level the playing field for responsible small businesses and preventing a race to the bottom on wages and working conditions that disadvantages responsible small firms. When unscrupulous firms violate these standards, they disrupt that playing field.

For instance, firms that misclassify workers are shifting the burden to responsible firms in the form of potential higher taxes, higher unemployment insurance costs, and higher workers’ compensation costs for responsible businesses.

Without proper education of employers and enforcement of workplace standards, these standards are essentially null and void. They exist on the books but help neither workers nor responsible small business owners trying to compete and operate profitable establishments.

Traditionally, enforcement has come from two sources: employees taking action together when employers fail to meet workplace standards, and action by public agencies tasked with ensuring consistent, universal application of workplace requirements. As discussed in the next two sections of this report, both avenues are being undermined by large corporations, harming both workers and small businesses.

Main Street Small Business Owners Advocate for Universal Workplace Standards

Support for strong workplace standards is widespread among small businesses. A 2017 survey conducted by Main Street Alliance found that 64 percent of small business owners support a national paid family and medical leave program, while studies conducted by Small Business Majority have shown strong support for minimum wage increases and paid sick days. Consistent with these findings, many small business owners have called for higher minimum wages, earned sick and safe time policies, paid family and medical leave programs, and other job quality standards.

Around the country, these business owners have contributed to the adoption of state and local policies that contribute to a healthy workforce. This includes members of Main Street Alliance, who have collaborated with policymakers to develop groundbreaking job quality standards such as Minneapolis’ earned sick and safe time policy, Oregon’s paid family and medical leave program, and Seattle’s minimum wage. This collaboration has involved everything from calibrating policies to meet the needs of local small businesses to designing outreach and education programs that ensure smooth implementation.

Testifying before Congress, Palo Alto Software CEO and Main Street Alliance of Oregon member Sabrina Parsons explained in 2019, “Family and community are not just numbers in our bottom line, but they are part of our bottom line, and small business will be made stronger by policies that level the playing field and allow us to compete with large corporations on terms that benefit all the people small businesses serve.”
Forced Arbitration Undermines Consistent Workplace Standards and Hurts Small Business

Large corporations increasingly are using a legal tool known as forced arbitration to block consumers, small businesses, and employees from enforcing their rights before a judge and jury. This tool involves a provision — often embedded in the fine print of a boilerplate contract — requiring the customer, small business, or worker to enter private arbitration if they believe a corporation has violated their rights or committed wrongdoing against them. This system of private arbitration is tilted in favor of large corporations. By forcing employees and customers into arbitration, large corporations suppress claims, derive substantial financial benefit, and disadvantage smaller competitors.

The use of forced arbitration is growing at a rapid rate in the workplace, where employers may require employees to waive their access to judge and jury as a condition of employment. According to the Economic Policy Institute, more than 60 million workers in the U.S. were subject to forced arbitration as of 2017. With the recent Supreme Court decision in Epic Systems v. Lewis (allowing employers to block employees from arbitrating claims jointly), it is expected that by 2024 over 80 percent of private-sector nonunion workers will be blocked from going before judge and jury or from joining with other workers to assert their rights.

The use of forced arbitration reinforces racial and gender inequity in the workplace. Firms that employ large numbers of workers who are of color and/or women, or that pay low wages, are more likely to use mandatory arbitration. Sixty-five (64.5) percent of workplaces where the average wage is less than $13 an hour — almost two-thirds of these workplaces where very low-wage workers are more concentrated — require mandatory arbitration.

Though employers of any size may use forced arbitration, it is most common among large corporations. As of 2017, 65 percent of those with 1,000 or more employees had forced arbitration procedures. For firms with 5,000 or more employees, the rate is even higher, at 67.7 percent, compared to 49.8 percent for firms with fewer than 100 employees. Generally, as Cornell University professor Alexander Colvin has explained, "larger organizations with more sophisticated human resource policies and better legal counsel are more likely to adopt policies like mandatory arbitration that protect them against legal liability."

The forced arbitration system is designed to impede claims related to everything from wage theft to sexual harassment. In this system, large corporations determine the procedures, and proceedings happen behind closed doors, producing no public record to alert the public and small businesses to wrongdoing. These barriers deter workers from enforcing workplace standards and reward large corporations and other unscrupulous competitors that violate those standards.

Through forced arbitration, large corporations have made the enforcement of workplace standards so onerous and costly that few if any workers pursue it. According to law professor Cynthia Estlund, "It now appears that the great bulk of disputes that are subject to [forced arbitration]...simply evaporate before they are even filed." Estlund estimates that 98 percent of employment claims that workers could bring to arbitration are not actually arbitrated. This results in 315,000 to 722,000 “missing” arbitration cases every year.

In the tiny number of cases that do make it through arbitration, large corporations still win. As of 2011, workers prevailed in only about one-fifth of cases in forced arbitration (compared to 57 percent in state courts). Moreover, they recovered far less than their counterparts who are able to go before state judges:
on average, forced arbitration awards were only 7 percent of average awards in state court.\textsuperscript{35}

Forced arbitration delivers significant financial benefits to large corporations while putting responsible small employers at a disadvantage. By one estimate, forced arbitration has enabled employers to pocket $12.6 billion in wages owed to workers earning less than $13 an hour, increasing the incentives for large corporations to violate workplace protections.\textsuperscript{36}

The example of Darden Restaurants (owner of Olive Garden, Red Lobster, and other large chains) provides a powerful illustration of how forced arbitration rewards large competitors that violate workplace standards. According to one analysis, since 2005, Darden has paid $14 million to settle lawsuits concerning working conditions. Yet, when Darden forced similar claims through the country’s two dominant arbitration firms, workers won awards only 2 percent of the time and the company paid out a total of $73,961.\textsuperscript{37}

Small businesses pay the price when large corporations are able to opt out of workplace protections. By shifting claims to private arbitration, these corporations are using their size and market power to whittle away at major avenues for ensuring consistent, universal application of workplace standards intended to protect all workers and businesses.

\textbf{Main Street Small Business Owners are Themselves Victims of Forced Arbitration}

Many small businesses themselves have been subjected to forced arbitration clauses. These small businesses may turn to larger businesses as their suppliers or rely on large corporations to handle payment processing or other important services. In these cases, large corporations may embed forced arbitration clauses in contracts, denying their small business customers their day in court to challenge abusive practices just as employees are denied their rights. Just such a forced arbitration clause was at issue in American Express v. Italian Colors, a case in which a restaurant owner sought to join with other merchants to challenge American Express for anti-competitive practices, only to find his only option was to go to individual arbitration, the costs of which would exceed the amount the business owner could recover.\textsuperscript{38}

In 2015, the New York Times investigated this and other forced arbitration cases, examining thousands of records. “By inserting individual arbitration clauses into a soaring number of consumer and employment contracts,” it reported, “companies like American Express devised a way to circumvent the courts and bar people from joining together in class-action lawsuits, realistically the only tool citizens have to fight illegal or deceitful business practices.”\textsuperscript{39} Forced arbitration clauses have blocked customers from pursuing their rights against credit card companies, banks, phone carriers, and other corporations.

The corporations that use forced arbitration in employment contracts include the giants in many industries from Amazon and Walmart to Bank of America, FedEx, and H&R Block.\textsuperscript{40} With corporate concentration on the rise, forced arbitration is another tool through which large corporations expand their power and influence.
Public Agency Underfunding Hurts Small Businesses

From the moment the COVID-19 pandemic hit the United States, Main Street Alliance members requested clear, enforceable health and safety guidelines to help them operate as safely as possible and to set a floor for all competitors. One member explained that an enforced mask mandate was important for his business, providing crucial protection to him and his employees as they navigated the pandemic. This is just one example of the kinds of safety guidelines sought by small business owners to help them over the past year. Yet the public agencies that set consistent workplace standards, provide education on those standards, and enforce them are underfunded and understaffed.

As a result of this underfunding, state agencies have few if any investigators to examine cases of wage theft, discrimination, or other violations of workplace standards. For instance, as of May 2019, Maine had only a handful of investigators for more than 600,000 employees while Oregon had only 35 for 1.9 million. In some cases, states may have no personnel at all to look into claims, essentially nullifying protections that exist on the books.

This underfunding of such agencies hurts small businesses in multiple ways. When agencies lack the staff to investigate claims and apply penalties, the cost of compliance can grow higher relative to noncompliance, disadvantaging responsible employers and encouraging a race-to-the-bottom. Unchecked violation of workplace laws thus rewards unscrupulous employers, forces responsible business owners to pay the cost of their practices, and degrades the terms of competition for all business.

Underfunding also eliminates the resources that state agencies need for outreach and education of business owners on workplace standards, especially newly adopted ones. Members of Main Street Alliance have been involved in developing new workplace standards.

"To be successful in our business we need a couple of things: great employees and hot dogs made from the finest ingredients. Quality is a key role in our business so we don’t skimp on our food or how we treat our employees and don’t feel anyone else should. We would never use an employee contract filled with harmful terms like waivers for their rights. Skirting the rules is not acceptable. We need to protect basic workplace standards."

Robert & Diane Martin
Owners, Dee’s Hot Dog Stand, New Bedford, MA
standards, such as earned sick and safe time, and have identified adequate outreach as key to the success of such policies. For responsible small business owners, then, proper funding of state departments of labor and other relevant agencies and offices is important for multiple reasons. It makes it more likely they will receive the information and outreach they need, and it contributes to leveling the playing field through consistent application of the law.

Policymakers Should Act to Protect Responsible Small Businesses

Small businesses need solutions

Unscrupulous employment practices hurt workers, their families, and their communities. They hurt responsible small business owners, too. By undermining and underfunding enforcement of workplace standards, policymakers send the message that “that’s the way business works in America.” Lowering the cost of noncompliance rewards employers that abuse workers and raises the relative cost of running a responsible business.

Allowing widespread noncompliance also harms the overall economy. This harm is evident in the massive loss of wages due to wage theft, estimated at $15 billion a year lost to minimum wage violations alone even before the pandemic — an amount that exceeds losses due to shoplifting. Low-wage workers could recover $12.6 billion of these lost wages if not blocked by forced arbitration. These are dollars that workers and their families could spend in local businesses. Instead, they are going to unscrupulous employers.

To support the kind of competition that brings investment to communities — rather than extracting from them — responsible business owners need policymakers to send a different message. On the federal level, Congress has the power to protect small businesses and workers from the spread of forced arbitration. Federal lawmakers can do this by passing legislation overturning Epic Systems and banning

COVID has shown how bad actors impact responsible businesses and the economy overall.

“I don’t feel if I opened right away it would be responsible for the community, and it is something I feel really strongly about.....I am in debt like everyone else, but I don’t think it is fair to put everyone at risk for reopening sooner. The money in my pocket won’t make me feel as good if it means people are getting sick.”

Ilma Lopez, Chaval and Piccolo Restaurants, ME
forced arbitration and waivers of collective- and class-actions.

**The whistleblower enforcement option**

On the state level, approaches being developed in several jurisdictions provide models for comprehensive enforcement that help workers and protect responsible businesses from unscrupulous competitors. In this whistleblower enforcement model, an individual worker informs the state agency of violations, and either the state agency pursues the case on behalf of a group of workers, or the employee pursues legal action on behalf of both workers and the state agency. When the employee pursues legal action as a whistleblower, the employee is suing in the shoes of the state rather than as an individual. Unlike with individual claims, forced arbitration clauses would not bar these kinds of whistleblower actions.

Under this approach, a portion of the penalties recovered through the worker’s whistleblower action help bring wages and working conditions back to the standard with which businesses are expected to comply. The majority of the penalties goes to the state agencies to help fund their education and enforcement activities, so that wrongdoers are contributing to the maintenance of consistently applied standards — rather than profiting from violation of those standards.

California has more than fifteen years of experience with this whistleblower approach. Under the Private Attorney General Act (PAGA), passed in 2003, workers can bring representative actions on behalf of the state. In the last four years these lawsuits have resulted in significant recovery of funds from lawbreaking businesses, resulting in $42 million in increased funding annually for the state’s education and compliance efforts. Fully 89 percent of PAGA claims allege wage theft, while 12 percent involve earned sick leave. These violations are of particular concern to responsible small businesses.

PAGA has been amended and improved since its initial adoption. Recognizing that employers may mistakenly or inadvertently commit paperwork or other errors, PAGA now provides employers an opportunity to correct (or “cure”) certain violations, including a number of wage statement violations. According to California state records, employers have taken such corrective action 7 to 12 percent of applicable cases, suggesting that this option is important for businesses that make innocent mistakes but that such mistakes represent a very small portion of violations.

With the vast majority of PAGA claims involving allegations of wage theft, this whistleblower option provides an avenue for bringing large corporations and other unscrupulous competitors into compliance with standards that affect both workers and responsible competitors. The whistleblower approach thus protects the terms of competition in the state, and, along with the state’s job quality standards, supports

“In my nearly 40 years as a small business owner I held numerous contracts, many with businesses far larger than mine. Small businesses like mine are severely disadvantaged in any contract disputes that are subject to forced arbitration by a much larger multinational corporation.”

*Jim Houser, Hawthorne Auto Clinic Founder, Portland, OR (retired)*
improved income for lower-wage workers, who can then increase their consumer spending. Overall, PAGA has contributed to a more equitable and robust economy during a time of growth for the state. Since 2006, California’s per capita income has risen from 10th in the nation to 6th, with job growth stronger than the national average. Moreover, California has taken steps in recent years to bolster workplace standards (including a minimum wage increase and a paid sick days policy) along with enhancing environmental protection and strengthening the safety net. From 2011 to 2016, as the state adopted these measures, it experienced 17.2 percent growth in gross domestic product, almost double the average growth of certain states that typically have not pursued such policies. By fostering compliance with these policies, PAGA promotes a more equitable economy for workers and responsible small businesses alike.

Accordingly, Main Street Alliance makes the following recommendations:

- State lawmakers should adopt whistleblower enforcement programs, providing employers an opportunity to correct violations, to protect workers and small businesses and help ensure that competition takes place on a fair, level playing field.

- Congress should overturn the Supreme Court’s decision in *Epic Systems* and prohibit forced arbitration and class- and collective-action waivers in workplace claims.

"When large corporations can use their size to coerce new employees into accepting forced arbitration, we all lose. By reducing the risk associated with violating employee rights, forced arbitration lowers the cost of being a low-road employer, to the detriment of the community as a whole. With the sheer volume of the business they are offered, arbitrators have a perverse incentive to find on behalf of the corporations that hire them. Corporations like Walmart, Uber or McDonald’s, all of whom have required at least some, if not most, employees to sign such agreements, can use forced arbitration as a means to cut tens of thousands of working folk and local consumers off from the protections of the courts and the possibility of appeal. And that just further tilts an already unlevel playing field to the advantage of large corporations over small businesses, the real engines of innovation and the moral heart of our local communities."

*David Borris, Hel’s Kitchen Catering Founder, Lincolnshire, IL (retired)*
Main Street Alliance and its small business owners have a long history of advocating policies that level the playing field for small businesses. These policies help small businesses sustain quality jobs, foster a more robust small business sector, and contribute to thriving local economies. However, even the best standards are meaningless if large corporations persistently violate them and are rewarded, rather than punished, for their wrongdoing. When this happens, responsible small businesses pay the price.

The COVID-19 pandemic has shown how willing some unscrupulous large businesses are to expose their employees and others to grave risk in pursuit of profit. What was true before the pandemic is even more true now: policymakers must take action to stop this race-to-the-bottom, instead supporting the Main Street businesses that support their communities.

“My woodworking firm does most of its business in New York City, a cutthroat market. We’re a small operation running on tight margins, but we do everything we can to treat our employees right, including good salaries and benefits. If larger competitors can hire lawyers to scheme ways to get employees and customers to sign away their rights, those of us who do right by our workers and customers get squeezed even more. Everyone’s got to hustle in New York City, but everyone should play by the same set of rules. For consumers and contractors, the widespread use of arbitration is just another way for big dogs to keep small dogs in line. The whole system depends on the originators stipulating arbitration as a contract term, whether that applies to employees or vendors and subcontractors. As long as the income stream is being guaranteed by those writing arbitration into contractual agreements, arbitration is inherently unbalanced as the arbitrator’s bread is buttered on the originator’s side, not the customer’s, contractor’s, or employee’s.”

Kelly Conklin, Foley-Waite LLC, Kennilworth, NJ
Endnotes

19. https://laborcenter.berkeley.edu/face-to-the-bottom/
22. https://3n8a8pro7vnhx.cloudfront.net/mainstreetalliances/pages/886/attachments/original/1567526912/MSA_PFML_Report_-_Phase_1_v3.pdf?1567526912
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See, for example: https://www.clasp.org/sites/default/files/2018_seattleolsemployees.pdf


